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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No. 1159

UNITED STATES OF AMERICA,

Respondent,

—against—

CARL J. SIMON, ROBERT H. KAISER and MELVIN S. FISHMAN,

Petitioners.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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February 7, 1970

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Preliminary Statement

The three petitioners, a senior partner, a junior partner and a senior associate in the accounting firm of Lybrand, Ross Bros. & Montgomery ("Lybrand"), were convicted by a jury of mail fraud and of conspiring to violate the securities laws by preparing and certifying a false financial statement of Lybrand's client, Continental Vending Machine Corporation ("Continental").

The trial judge who presided at the second of two lengthy jury trials (the first having ended with a hung jury that stood 11-to-1 for acquittal) imposed fines but no prison sentences. The conviction is nevertheless a professional

death sentence for three men whose only connection with the company and its financial statement was as independent auditors and who, as trial judge and Court of Appeals agreed, led "exemplary" lives, "stood to gain nothing" by the alleged fraud (1c, 3c)* and "obviously" were not "wicked men with designs on anyone's purse" (25a).

The trial judge, who said he probably would have acquitted had he been the trier of the facts (1b), was constrained to say in passing sentence that while the decision to prosecute the case "lay entirely within the province of the United States Attorney," the "remedy" in "such a technical area [the proper accounting practice in reporting transactions in financial statements] where there was so much difference testified to between experts" lies not in "jail sentences" but rather in SEC regulations and pronouncements by professional bodies which would be wholly prospective in their operation (2c).

These highly pertinent observations of the trial court lend all the greater seriousness to the fundamental error the court committed in charging the jury with respect to the all-important element of the case—the standard by which defendants' conduct of their engagement was to be judged.

The court refused to charge that the fairness of presentation of the financial statements and defendants' performance of their engagement were to be judged according to generally accepted accounting principles, but instead left the jury free to create and apply an altogether subjective

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* Citations to the opinions below are designated by page references followed by "a", "b" or "c" and refer to the appendices to this petition. Record references are to the document number, *e.g.*, R. 120, p. 3, or to the trial transcript, *e.g.*, Tr. 3442. Exhibit references are designated by number, *e.g.*, Ct. Ex. 2.

ex post facto standard of its own. Thus the charge permitted the jury to convict even though it found that defendants' performance was in all respects in conformity with the standards of their profession.

The error of the trial court was compounded by the Court of Appeals' affirming on a ground not even submitted to the jury and indeed foreclosed as a basis of decision by the charge to the jury.

The basic accounting question presented was whether, in reporting loans to an affiliate, accountants should also inquire into and require disclosure of the use made of the money by the affiliate. While agreeing that ordinarily such disclosure would not be required, the Court of Appeals held otherwise here on the impermissible ground that petitioners knew that the president of their client, in causing the client to make advances to the affiliate and in borrowing from the affiliate, was guilty of "dishonesty" and "looting", and hence "full disclosure must be the rule." This rationale of decision was impermissible and precluded because the trial court had charged the jury that there was no evidence of criminality or dishonesty on the part of the president.

This petition therefore presents, first, the highly important question of whether professional men may be convicted of crime for their professional performance even if they have complied in every respect with the generally accepted standards of their profession, and, second, the important question of whether the Court of Appeals may rely upon a ground for affirmance never presented to and in fact foreclosed to the jury.

A third question presented is whether the trial court was without "power", as it deemed it was, to grant petitioners' motion to have this "highly technical and complex" case, as the trial judge described it, tried before the court without a jury rather than being subjected at the Government's arbitrary insistence to trial by a tribunal unequipped to follow the evidence and grasp the issues. The prosecutor not only twice refused to consent to petitioners' waiver of a jury, but failed to state any reason why the fair and impartial administration of justice required a jury when the defendants themselves wanted none. Against defendants' motion for a direction of trial by the court without a jury because of the extremely complicated nature of the case, the prosecutor offered only the opinion that the Government had the absolute right to a jury trial as a matter of law.

Here it is apparent from the trial record, which consisted in the main of voluminous exhibits and thousands of pages of testimony relating to intricate accounting matters, that no jury of laymen could understand the issues presented. Indeed, even a person versed in financial affairs could not follow or evaluate the evidence without an opportunity to study the documents as they were presented, to make notes, and to question the witnesses when understanding became difficult. None of this was possible for twelve jurors and no one could ever have conceived that it was.

Accordingly, this petition also presents for this Court's review the question whether a federal prosecutor has the absolute right to present complex and technical issues for decision by those least able to comprehend them.

The Opinions Below

Petitioners seek review of a judgment of the United States Court of Appeals for the Second Circuit affirming petitioners' conviction after a second jury trial. The opinion of the Court of Appeals (Friendly, Waterman and Smith, *C.JJ.*) was rendered November 12, 1969, is not yet officially reported and is printed as Appendix A to this petition.

The opinion of the District Court (Mansfield, *D.J.*), denying petitioners' motion for judgment or, in the alternative, for a new trial after the second trial, is unreported and is printed as Appendix B to this petition.

The opinion of the District Court in sentencing the petitioners is unreported and is printed as Appendix C to this petition.*

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* Earlier opinions in the case include the following:

An opinion of the United States District Court for the Southern District of New York (Bryan, *J.*), enjoining the taking of petitioners' depositions for a period of 90 days in a civil action that was then pending in the United States District Court for the Eastern District of New York, was filed on December 12, 1966, and is reported at 262 F. Supp. 64. An opinion of the United States Court of Appeals for the Second Circuit (Lumbard, *Chief Judge;* Smith and Feinberg, *JJ.*), dissolving the injunction, was rendered on March 3, 1967, and is reported at 373 F.2d 649. A writ of certiorari to review that judgment of the Court of Appeals was issued May 8, 1967 and is reported at 386 U.S. 1030. An order vacating the writ of certiorari, after the civil action in the Eastern District of New York was settled and dismissed, was rendered on December 18, 1967 and is reported at 389 U.S. 425 (No. 72, O.T. 1967).

The opinion of the United States Court of Appeals for the Second Circuit (Lumbard, *Chief Judge*; Kaufman and Hays, *JJ.*), holding, (on the Government's application for mandamus) that the second trial should take place before a judge other than the one who presided at the first trial, was rendered on April 17, 1968 and is reported at 393 F.2d 91.

Jurisdiction

The judgment of the Court of Appeals was rendered on November 12, 1969 (R. 122). A petition for rehearing was denied on December 10, 1969. By order signed December 29, 1969, Mr. Justice Harlan extended to February 7, 1970 the time for filing a petition for a writ of certiorari. Jurisdiction is conferred on this Court by 28 U.S.C. § 1254(1).

Questions Presented

1. May professional men be convicted of a crime arising out of the performance of their professional undertaking when their conduct has conformed in every respect to the generally accepted standards of their profession?

2. May a Court of Appeals affirm a jury verdict in a criminal case on a theory of culpability which was not submitted to the jury and was in fact precluded to the jury by the trial court's charge?

3. Does a District Court have power to grant a defendant's motion for a non-jury trial of complex and technical issues, over Government objection, when the defendant has articulated substantial reasons why a jury trial would be unfair and the Government has advanced no reasons why a jury trial is appropriate?

Statutes and Rules Involved

The statutes pursuant to which petitioners were convicted are Sections 371, 1001 and 1341 of Title 18 of the United States Code and Section 32 of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff. The Rule involved is Rule 23(a) of the Federal Rules of Criminal Procedure. These statutes and rules are set forth in Appendix D to this petition.

Statement of the Case

The indictment charges mail fraud and conspiracy to violate the federal securities laws in connection with the financial statements of Continental Vending Machine Corporation for the fiscal year ended September 30, 1962 (R. 1).

The Lybrand firm certified Continental's financial statements for that year and had served as Continental's auditors since 1956. Petitioner Simon was the Lybrand partner in charge of the Continental engagement for 1962, petitioner Kaiser was the second partner on the assignment and petitioner Fishman, an employee of the Lybrand firm, served as manager of the audit team, which consisted of 17 members of the Lybrand staff (8a; Tr. 1929).

All charges of the indictment revolved around loans made by Continental to an affiliate company, Valley Commercial Corporation, and loans made by Valley to Roth, who was president of Continental and the controlling stockholder of both companies. The Government's principal charge of alleged falsity was that the Continental financial statements did not disclose the loan transactions *between Valley and Roth,* which at the end of the report year left Roth indebted to Valley in approximately the same amount as Valley's indebtedness to Continental. It was also claimed that the statements should have disclosed that the collateral posted to secure the Valley receivable consisted principally of Continental securities, that the amount of the Valley receivable had increased between the year-end reported on and the date of certification, and that the Valley receivable and notes payable to Valley by Continental could not be offset. An inadvertent error in a footnote which netted the

payable and receivable was conceded, but the controlling balance sheet itself correctly showed the two items as separate and not netted.

Eight eminent accounting authorities who testified for the defense all stated that the reporting was in accord with generally accepted accounting principles. As to the principal claim that Roth's borrowing from Valley should have been disclosed in Continental's financial statements, all testified that such disclosure was not only not required by generally accepted accounting principles, but would have been inappropriate (Tr. 3067, 3129, 3184, 3212, 3250, 3277, 3375, 3549).

The reasoning of the defense experts was sufficiently persuasive that the trial court considered the central issue of whether petitioners were under the duty to disclose Roth's borrowings to be "barely submittable" to the jury (Tr. 3707). As the experts testified, it was *Continental's* financial statements, not Valley's which petitioners were auditing and reporting upon. Valley was a substantial business of its own, its financial statements were not consolidated with Continental's, and petitioners were not Valley's auditors. All that mattered in Continental's financial statements was that the Valley affiliation be disclosed, which it was, and that the receivable from Valley was collectible. What Valley did with the money which it received from Continental was not a matter to be reported upon in Continental's financial statements. Therefore all the experts agreed that the Continental accountants would not be expected to go behind the Valley receivable in reporting on Continental's financial statements.

The importance of testing petitioners' conduct by their adherence to generally accepted accounting principles is

enhanced by the complete absence of motive to falsify, which has heretofore been deemed to be such an important element in a fraud case. *E.g., Freidus* v. *United States,* 223 F.2d 598, 603 (D.C. Cir. 1955); *United States* v. *Wise,* 108 F.2d 379, 381-82 (7th Cir. 1939).*

The theory of motive propounded by the prosecution, without any evidentiary support, was that petitioners fraudulently covered up Roth's borrowings from Valley in the 1962 financial statements because they had failed to disclose Roth's borrowings from Valley, conceded by the Government to be immaterial in amount (R. 118, p. 127), in prior Continental financial statements. Fear of revealing their alleged negligence in prior years was suggested as prompting a fraudulent concealment in 1962. There was no evidence, however, of petitioners having any concern over their prior audits and the fanciful theory of any such negligence and fear was completely negatived by the evidence that their peers in the profession firmly believed that any such disclosure as the Government argued should have been made was not

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* The Court of Appeals observed in its opinion:

> "None of the defendants made or could make a penny from Continental's putting out false financial statements. Neither was there evidence of motive in the sense of fear that telling the truth would lose a valuable account. Continental was not the kind of client whose size would give it leverage to bully a great accounting firm, nor was it important to the defendants personally in the sense of their having brought in the business. One would suppose rather that the Continental account had become a considerable headache to the Lybrand firm generally and to the defendants in particular; they could hardly have been unaware of the likelihood that the many hours the firm had devoted to the 1962 audit would not be compensated and that another might never occur. Ordinary commercial motivation is thus wholly absent." (24a)

only uncalled for but entirely inappropriate.* And the notion that petitioners were not acting independently and honestly is refuted by their insistence, over objection, upon disclosure of Continental's grim and dismal financial condition; release of the financial statements led quickly to suspension of trading in Continental's securities.

Shortly after the indictment was returned the case was assigned by reason of its complexity to Judge Bryan for all purposes, including trial (R. 7). Before the first trial began, petitioners waived their right to trial by jury and moved for trial by the court, fully explaining the reasons why jury trial of this case would be inappropriate (R. 24, R. 116, pp. 4-9, Peck Aff.). The Government refused to consent and the motion was denied (R. 116, pp. 10-16). The first trial began on December 5, 1967 and continued for nine weeks until the jury was discharged upon its inability to agree. When discharged, the jury stood 11-to-1 for acquittal (R. 120, p. 25).

Thereafter the case was assigned for all purposes to Judge Mansfield (R. 37), who convened the second trial on May 20, 1968. Once more petitioners waived their right to trial by jury, sought trial by the court alone, the Government refused to consent, and petitioners' application was denied (R. 117, pp. 2-3).

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* By the time of summation at the second trial the prosecutor was sufficiently disenchanted with his theory of motive as to amend it to an alleged prior neglect to bring Roth's borrowing in past years to the attention of Continental's Board of Directors. The trial court in its denial of defendants' post-trial motions considered this alleged failure as the assigned motive (Tr. 4045-46) and the Court of Appeals opinion also reflects it. (24a) The unquestioned evidence was that all of the directors, with the possible exception of a deceased director, knew of Valley's borrowing from Continental and Roth's borrowing from Valley.

The jury, after being deadlocked overnight, returned a verdict of guilty on June 21, 1968 (Tr. 4233). Judge Mansfield imposed no prison sentence, but fined petitioner Simon $7,000 and petitioners Kaiser and Fishman $5,000 each (3c).

Reasons for Allowance of the Writ

I

The charge to the jury erroneously permitted conviction even if the jury found that the petitioners adhered in every respect to the standards of their profession.

The question here urged for the Court's consideration is of the greatest importance to the public and to all professional men. That question is whether professional men may be convicted of crime for professional service performed in conformity with generally accepted professional standards.

The novel use of the criminal process to establish and modify professional obligations, instead of seeking pronouncements of announced changes from governing professional bodies or such administrative agencies as the SEC, poses problems of public importance just short of constitutional dimension. Changing professional rules without previous notice, subject to criminal sanctions for violations, is close to denial of due process. Certainly, we submit, such procedure is sufficiently improvident and the consequences both sufficiently dangerous to the individual rights of professional men and prejudicial to the public interest as to call for exercise of the Court's discretion in favor of review.

It is unquestioned in civil litigation that "Accountants should not be held to a standard higher than that recognized in their profession." *Escott* v. *BarChris Constr. Co.*, 283 F. Supp. 643, 703 (S.D.N.Y. 1968), and this is the rule applicable to professions generally.* *A fortiori*, this principle should govern in a criminal case. Yet the trial court here rejected this principle, and by its charge permitted conviction even if the jury found that petitioners' performance of their professional engagement conformed in every respect to the accepted standards of their profession.

The issue is the more pointed inasmuch as petitioners' only connection with Continental and Continental's financial statements was as independent accountants. Lybrand's only undertaking and representation were that their examination "was made in accordance with generally accepted auditing standards" and that, in Lybrand's opinion, the financial statements, taken as a whole, fairly presented the financial position and results of operations of Continental "in conformity with generally accepted accounting principles." (Gov. Ex. 1-A-1). It would thus seem clear that there could be no fraud unless to petitioners' knowledge the presentation did not conform to generally accepted accounting principles.

Eight expert independent accountants, described by the Court of Appeals as "an impressive array of leaders of

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* PROSSER, Law of Torts 167-168 (3d ed 1964); See *e.g. Pike* v. *Honsinger*, 155 N.Y. 201, 209-210, 49 N.E. 760, 762 (1898); McCoid, *The Care Required of Medical Practitioners*, 12 Vand. L. Rev. 549, 614 (1959) (medicine); *Spangler* v. *Sellers*, 5 Fed. 882, 887 (C.C.S.D. Ohio 1881) (law); *Gammel* v. *Ernst & Ernst*, 245 Minn. 249, 72 N.W. 2d 364, 367 (1955); Hawkins, *Professional Negligence Liability For Public Accountants*, 12 Vand. L. Rev. 797 (1959); Note, *Accountants' Liabilities for False and Misleading Financial Statements*, 67 Colum. L. Rev. 1437 (1967) (accounting).

the profession" (16a), testified that petitioners' certification of Continental's financial statements was not in any way inconsistent with generally accepted accounting principles (Tr. 3067, 3129, 3184, 3212, 3250, 3277, 3375, 3549). Even if it be assumed that the testimony to the contrary of two SEC accountants, who the Court of Appeals noted "hardly compared with defendants' witnesses in aggregate auditing experience or professional eminence" (17a) presented a question of fact and credibility for the jury to resolve, if the jury believed the evidence of the independent accounting witnesses as to what generally accepted accounting principles were and that petitioners' conduct accorded therewith, that should have been the end of the case. Nevertheless, the trial judge refused to so instruct the jury or make their finding as to generally accepted accounting principles determinative, but instead permitted the jury to convict even if it credited defendants' experts and found that petitioners complied in every respect with the standards of their profession.

The District Court erroneously refused to charge as follows (Ct. Ex. 2, pp. 15-17):

> "41. Thus, a defendant may be found guilty only if you find beyond a reasonable doubt that the financial statements as a whole did not fairly present the financial condition of Continental at September 30, 1962, according to generally accepted accounting principles, that he knew that the financial statements as a whole did not fairly present the financial condition of Continental at September 30, 1962, according to generally accepted accounting principles, that he participated in the certification with this knowledge and with the intent to deceive and defraud.
>
> "44. If defendants' certification of the Continental financial statements was rendered in accordance with

> generally accepted accounting principles, they must be acquitted without regard to any opinion you might otherwise form as to proper standards. Only if the defendants failed to comply with the generally accepted standards of their profession can there be any question of wrongdoing on their part. If they did fail in material respects, then the question is whether their failure was due to inadvertance, mistake, negligence or a wilful disregard of those standards with knowledge of falsity of the statements certified and with intent to deceive. Only in the last event may they be found guilty."

Instead of so charging, the trial judge instructed the jury that the "critical test" was whether the financial statements as a whole "fairly presented the financial position of Continental as of September 30, 1962"— omitting the critical standard "according to generally accepted accounting principles." Also, the required coverage of financial statements, as defined by the court, was what "an average, reasonably prudent person would attach importance" to "in deciding whether or not to buy or sell stock, or to lend or refuse to lend money, or to cancel a loan," rather than what would be expected in accordance with accepted accounting practice. Adherence to generally accepted accounting principles was only a factor that might be considered on petitioners' good faith, as to which such adherence might be "persuasive," but not "conclusive" (Tr. 3973, 3979-82).

This charge gave the lay jury license, acting with the benefit of hindsight, to judge petitioners' professional performance according to its own untutored and subjective judgment, based solely on some concept of what an investor would like to have disclosed. The well-established distinction between the limited information that accountants may

expect and require their clients to disclose in financial statements and the broader range of disclosures required in other documents, as in annual reports to stockholders, proxy statements, prospectuses and periodic filings with the Securities and Exchange Commission, was not duly observed.

The charge thus permitted the jury to ignore the principle that the conduct of a professional man, as to any matter on which the standards of his profession might differ from those of a layman, must be tested against the standards of the profession.

So far as we know, never before has any jury been permitted to determine the guilt or innocence of a professional man in the conduct of a professional engagement on any basis other than adherence or non-adherence to the standards of his profession. The doctor, lawyer, engineer or accountant, accustomed and obliged to practice in accordance with the teachings of his profession, could not salutarily serve with the prospect that he must answer criminally—even if not civilly—to a lay judgment on lay standards conceived after the event.

The standard of guilt or innocence which the court permitted to the jury here is so unjust and would so inhibit the disciplined performance of professional engagements that this Court should pass upon and correct the error committed in this respect by both the Court of Appeals and District Court.

II

The Court of Appeals erroneously affirmed and held that generally accepted accounting principles were not the standard for judging petitioners' professional performance on a theory of culpability that was foreclosed to the jury.

The heart of the case was the question whether petitioners were under the duty to disclose in Continental's financial statements Roth's borrowing from Valley. "Everything"—all the claimed deficiencies in the financial statements—was "designed," the prosecutor said, "to conceal that Roth got the money" (Tr. 3851-52).

As previously noted, eight recognized accounting authorities testified that the disclosure the Government contended should have been made was not required and would not be expected by generally accepted accounting principles, and even that such a disclosure would have been inappropriate.

Defendants maintained before the Court of Appeals that the trial court was in error both in respect to its charge and in submission of the principal issue to the jury. The Court of Appeals affirmed, but in so affirming exceeded the permissible scope of appellate review by sustaining the verdict on a theory of the case which was foreclosed to the jury.

The Court of Appeals ruled that generally accepted accounting principles did not instruct as to the disclosure that should have been made in this case, and that the verdict was justified, because independent accountants have a responsibility "to reveal known dishonesty by a high corporate officer," here that the president had "looted" the corporation (19a). But the jury had neither found nor been allowed to

find "known dishonesty" or "looting" on the part of the president, nor was any such theory of culpability submitted to the jury, for the trial court had charged:

> "I should advise you that there is no evidence that Continental's advances to Valley or Valley's advances to Roth were in any sense criminal. The testimony of Roth and Claire Gans was that there was no intention to steal the money, but rather the intention was to borrow and to repay it. All of Continental's advances to Valley were recorded as such, for instance, on Continental's and Valley's books, and all of Valley's advances to Roth were recorded on Valley's books. In fact, in prior years, Continental's advances to Valley were repaid, and in 1962 there were repayments by Valley to Continental of approximately $2 million." (Tr. 3992)

Rather than any claim of "dishonesty" or "looting," the Government claim presented in the charge to the jury was that the loans from Continental to Valley should have been regarded as "indirect loans" to Roth and disclosed in the same manner as "direct loans," (Tr. 4002) while the defense experts testified that such treatment would have been inappropriate even if petitioners knew that Continental's advances to Valley were for the purpose of putting Valley in funds to loan to Roth.

The testimony of the accounting authorities was addressed to the precise predicate of culpability advanced by the Government. They testified particularly that under the circumstances posed by the prosecution the disclosure the Government contended for should not have been made. The Court of Appeals was thus doubly in error in holding that generally accepted accounting principles did not cover the case, and in basing its holding on assumptions of dishonesty and looting

that could not have constituted the basis for the jury verdict. For not only was no such issue submitted to the jury but such basis for a verdict was precluded by the court's charge.

Certainly if petitioners were to have a jury foisted upon them they were entitled to have the jury pass on the theory of culpability on which they were to be ultimately held. If known dishonesty and looting was to be the ground of decision, defendants were entitled to have that version of the facts submitted to the jury for determination along with the question of whether generally accepted accounting principles covered the case. As it is, petitioners have been whipsawed between a jury left with no standard of guidance and a court that has upheld the verdict on grounds which could not have been the basis for the jury's verdict.

This Court has consistently reversed convictions based on a jury verdict when there is any possibility that the jury might have convicted on a ground other than one properly submitted to it. *Street* v. *New York,* 394 U.S. 576 (1969); *Yates* v. *United States,* 354 U.S. 298 (1957); *Terminiello* v. *Chicago,* 337 U.S. 1 (1949); *Stromberg v. California,* 283 U.S. 359 (1931). *A fortiori,* an appellate court should not be permitted to affirm a conviction on a theory of culpability which could not have been the basis for the jury's verdict.

We urge that in the circumstances of this case, the Court should exercise its supervisory power over the federal judicial system to correct such fundamental and critically prejudicial error.

III

Petitioners were deprived of a fair trial by the prosecutor's unjustified insistence upon trial by jury.

Petitioners waived their right to trial by jury and moved for trial by the court because they were convinced that no jury could understand the case and that, lacking full comprehension and the facilities for following the case in the course of its detailed presentation, a jury trial would lack essential fairness.

The prosecutor refused to consent to petitioners' waiver of a jury and the District Court considered itself bound by *Singer* v. *United States,* 380 U.S. 24 (1965), to acquiesce in the prosecutor's refusal.

The defendant in *Singer,* however, had advanced no reason for a non-jury trial other than the wish to expedite the proceedings. The Government, on the other hand, advanced to this Court several reasons why a jury trial was particularly appropriate in that case (Brief for Respondent at 27-28, *Singer* v. *United States*). This Court, in holding Rule 23(a) constitutional on its face, left open the question of how that Rule might be applied in cases where the petitioner's reasons for waiving jury trial might be more substantial:

> "We need not determine in this case whether there might be some circumstances where a defendant's reasons for wanting to be tried by a judge alone are so compelling that the Government's insistence on trial by jury would result in the denial to a defendant of an impartial trial." 380 U.S., at 37.

The issue left open in *Singer* is clearly presented here.

Before the first trial petitioners demonstrated that trial by jury was wholly unsuitable to this case and would not provide basic essentials of a fair trial (R. 24; R. 116, pp. 4-9). The accuracy of that forecast was demonstrated in both trials by the evidence and the 135-page charge of the court.

Unlike *Singer,* a relatively simple mail fraud case which the Government argued was particularly apt for jury consideration, the judge at the first trial here recognized that this was "an extremely complicated case" (R. 116, p. 15). The trial judge felt compelled by *Singer* to deny petitioners' motion for a non-jury trial because there had not been, as there never could be, a showing of *no* "possibility of obtaining a fair trial before a jury," and he thought that absent such a showing, he had no "power" to override the prosecution's preference (R. 116, p. 14).

In this case the Government, citing *Singer,* did not set forth at either trial its reasons for withholding consent. It offered no more than the pretense that this was a "simple" case (R. 116, p. 11). The prosecutor's conduct here suggests that he was less concerned with doing justice than with assuring that the issues would be submitted to those least able to comprehend them.

Wholly inapplicable here are the considerations which are said to make a jury the preferable fact-finding body in criminal cases. In many types of cases a jury may be a better fact finder because it better represents community standards. In *Singer,* for instance, twelve members of the community were perhaps more fit than a judge to decide whether the fraudulent representations in the scheme there involved (to dupe

amateur songwriters into sending money to market their songs) were likely to deceive the gullible. This case, however, involves complicated accounting principles and practices that laymen do not ordinarily deal with and generally cannot be expected to comprehend.

Mere reference to the nature of the proof shows beyond cavil that the case was not at all "simple," as the prosecutor pretended in insisting upon a jury trial, but was, as Judge Bryan described it, "extremely complicated," (R. 116, p. 15) and as Judge Mansfield described it, "highly technical and complex" (2c). Not only were professional practices the principal subject of the testimony, and intricacies of corporate accounting practice such as quasi-reorganizations, the distinction between income charges and surplus charges, and capitalization and amortization of development expenses debated, but the trial record is replete with such papers as detailed and multicolumnar auditing work sheets, draft financial statements with handwritten editorial changes, voluminous schedules showing the relationship of cash receipts and disbursements and various technical summaries of adjustments to Continental's books.

Days of trial testimony were devoted by a number of witnesses to explications of detailed papers such as these. The papers themselves were incomprehensible without explanatory testimony, and the testimony itself was incomprehensible to anyone who did not have spread before him, while the witnesses testified, the documents in question, and did not have the opportunity to make notes and put questions when understanding became difficult. Full comprehension was impossible for the jury, and this was as apparent before the first trial

began as it was when the case was finally submitted to the second jury.*

The nature of the proof and difficulty of comprehension are not the only considerations here, however. The constraints of our judicial system are such that even an uncommonly intelligent jury, sitting passively in the jury box, would be less likely to grasp the case than a judge. A judge has the opportunity, denied the jury, to familiarize himself with the nature of the case prior to trial—during the pre-trial proceedings and by requesting briefs on points that perplex him. At trial he has the advantage of being able to interrogate witnesses for clarity of understanding, to closely follow a documentary case by reference to the documents as the evidence and explanations go in, and to take notes. And finally, a judge does not have to decide such a case locked in a room without the transcript, but may take as long as necessary, with the aid of post-trial briefs and proposed findings, to render a fair decision.

We assume that when this Court in *Singer* contemplated a case "where a defendant's reasons for wanting to be tried by a judge alone" might be "compelling" and the Government's "insistence upon trial by jury would result in a denial to a defendant of an impartial trial," it was

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* The jury was obviously enmeshed in the evidence at the critical point of its deliberations, when in announced deadlock at 9:15 at night it asked in two questions if there was evidence supporting the Government's contentions with respect to cross-collateralization. The questions involved such delving into complex documents and the intricacies of marshalling collateral that court and counsel were engaged for the next two hours that evening and for an hour the next morning in colloquy as to what the record showed and what the supplemental instructions should be. In the end the court refused to answer one of the two questions upon the ground that he could not understand what was meant by the question (Tr. 4106-4221).

not suggesting, as Judge Bryan seemed to think, that the defendant's showing of reason had to rise to proof conclusive that there was no possibility of obtaining a fair trial before a jury. The threshold test of trial fairness and impartiality must be the likelihood that twelve jurors will have the capacity of understanding the case.

Basic to this Court's determination in *Singer* was the common law concept of the "intrinsic fairness" of a trial by jury and the consequent "legitimate interest" in the Government's seeking trial by the tribunal "most likely to produce a fair result."

In the exceptional situation, however, in which there cannot be the expectation that a jury will comprehend the case, the intrinsic fairness of jury trials generally ceases to be justification for insistence upon a jury trial. "Reason" for wanting trial of such a case by a judge who does have the training and experience to assure understanding and the facility, denied to a jury, of closely following a documentary case is then established, and there is no countervailing "legitimate interest" of the Government in trial by a tribunal less likely to comprehend the case.

Surely, the constitutional right to a jury trial, including what might be the defendant's preference for the undisciplined judgment of laymen, does not entitle the Government to insistence upon such a tribunal, in subversion of a defendant's paramount right to the essence of a fair and impartial trial—a tribunal able to comprehend all facets of the case and a mode of trial that facilitates understanding.

The present case can only be contrasted with *Singer*, where the defendant in a simple mail fraud cause offered on the "opening" of the trial to waive a jury "for the

purpose of shortening the trial." Here defendants waived their right to a jury trial well before the commencement of trial and moved with fully spelled out and compelling reasons for trial by the court without a jury.

We recognize that Rule 23(a) read literally provides that waiver of jury trial requires the Government's consent, but *Singer* itself shows that the Rule need not be construed as inflexibly as it has been here. Indeed, the requirement that a prosecutor must agree to the waiver of a jury has been widely criticized, both before and after *Singer*:

> "I could never understand why a defendant should be required to secure the consent of the court and the prosecutor. The effect of this rule is that either the court or the prosecutor can force a jury on him when he does not want it. There is an argument in favor of the court where the death penalty is involved and the court prefers to be excused, but that is subject to debate. In cases involving public passions and prejudices a judge is in danger of an unpopular decision. All of these matters occur to me in considering the position of the judge, but where is the prosecutor entitled to a vote?" Stewart, Federal Rules of Criminal Procedure (1945).

> "In sum, there are no substantial state interests opposed to defendant's absolute right to non-jury trial, at least none that would not be equally opposed to his conceded right to trial by jury. On the other hand, many substantial interests of the accused would be jeopardized by refusing him the right to waive the jury trial privilege. . . . [A]s a matter of basic fairness to the defendant who distrusts the tribunal and as a matter of avoiding arbitrariness in the denial of what may be a justifiable request, the Government

ought not to be able to insist upon trial by jury." Note, *The Supreme Court 1964 Term,* 79 Harv. L. Rev. 56, 174-177 (1965).

See, also, Comment, *Government Consent to Waiver of Jury Trial Under Rule 23(a) of the Federal Rules of Criminal Procedure,* 65 Yale L. J. 1032, 1041-1044 (1956); ALI, CODE OF CRIMINAL PROCEDURE § 266 (1931); 3 ORFIELD, CRIMINAL PROCEDURE UNDER THE FEDERAL RULES § 23:41 (1966); A. HOLTZOFF, *A Criminal Case in the Federal Courts,* 1966 FEDERAL RULES OF CRIMINAL PROCEDURE 1, 18-19 (West pamphlet ed. 1966); Donnelly, *The Defendants' Right to Waive a Jury Trial in Criminal Cases,* 9 U. Fla. L. Rev. 247 (1956).

The law of many states permits waiver of jury trial by the defendant alone, or by the defendant with only the consent of the court.*

This case presents a unique opportunity for this Court to review the application of Rule 23(a) and to determine whether trial courts should be given some discretion to dispense with jury trials, even over Government objection, when good reason is advanced by a defendant and the Government suggests no reason for a jury trial.

CONCLUSION

A criminal trial, it is submitted, is neither the necessary nor proper forum for developing or revising professional practices. But whether or not this is to be tolerated, it should

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* See N.Y. Const. Art. I, § 2 and the other states listed in Annot., 51 A.L.R. 2d 1346, 1354-1360 (1957), Comment, *Government Consent to Waiver . . . . supra,* at 1042 n. 54, and 4 BARRON, FEDERAL PRACTICE AND PROCEDURE § 2122 n. 7 (1951).

be within the power of the court in the exercise of some discretion in highly technical and complex cases to order the case heard by a court without a jury. And if a jury must be impaneled, it is of the utmost importance that it be given to understand that professional performance is to be judged by accepted professional standards. And then an appellate court, whatever its view as to what the standards should be, may not affirm a conviction on grounds that were not presented for the jury's consideration and determination.

Defendants here were denied a trial by a tribunal suitable for the purpose, denied a judgment upon their professional work in accordance with the standards of their profession, and finally denied even such benefit as might be derived from a jury trial—submission to and determination by the jury of the grounds of decision—by the Court of Appeals affirming on a ground precluded to the jury.

The petition should be granted.

Respectfully submitted,

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February 7, 1970

APPENDIX A

Court of Appeals Opinion

APPENDIX A

Court of Appeals Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 562, 563, 564—September Term, 1968.

(Argued April 18, 1969 Decided November 12, 1969.)

Docket Nos. 32828, 32829, 32830

UNITED STATES OF AMERICA,

Appellee,

—against—

CARL J. SIMON, ROBERT H. KAISER and MELVIN S. FISHMAN,

Defendants-Appellants.

Before:

WATERMAN, FRIENDLY and SMITH,

Circuit Judges.

Appeal from a judgment of the District Court for the Southern District of New York, Walter R. Mansfield, *Judge*, convicting three defendants, after a verdict, of conspiring to violate 18 U.S.C. §§1001 and 1341 and §32 of the Securities Exchange Act of 1934, 15 U.S.C. §78 ff., by knowingly drawing up and certifying a false and misleading financial statement of Continental Vending Machine Corporation for the year ending September 30, 1962, and of using the mails to distribute the statement in violation of 18 U.S.C. §1341. Affirmed.

PETER E. FLEMING, JR., Assistant United States Attorney (Robert M. Morgenthau, U. S. Attorney for the Southern District of New York, Charles P. Sifton, Asst. U. S. Atty., of Counsel), *for Appellee.*

DAVID W. PECK (Sullivan & Cromwell, New York, New York, Marvin Schwartz and Thomas E. Patton, of Counsel), *for Defendants-Appellants.*

COVINGTON & BURLING, Washington, D. C. (David B. Isbell, James F. Strother and J. Peter Luedtke, of Counsel), *Attorneys for the American Institute of Certified Public Accountants, amicus curiae.*

FRIENDLY, *Circuit Judge*:

Defendant Carl Simon was a senior partner, Robert Kaiser a junior partner, and Melvin Fishman a senior associate in the internationally known accounting firm of Lybrand, Ross Bros. & Montgomery. They stand convicted after trial by Judge Mansfield and a jury in the District Court for the Southern District of New York under three counts of an indictment charging them with drawing up and certifying a false or misleading financial statement of Continental Vending Machine Corporation (hereafter Continental) for the year ending September 30, 1962. After denying motions for acquittal or a new trial, the judge fined Simon $7,000 and Kaiser and Fishman $5,000 each.

Count One of the indictment was for conspiracy to violate 18 U.S.C. §§1001 and 1341 and §32 of the Securities Exchange Act of 1934, 15 U.S.C. §78 ff. Section 1001 provides:

> "Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both."

Section 1341 makes criminal the use of the mails in aid of "any scheme or artifice to defraud." Section 32 of the Securities Exchange Act renders criminal the willful and knowing making of a statement in any required report which was false or misleading with respect to any material fact. Counts Three and Six charged two mailings of the statement in violation of 18 U.S.C. § 1341. Nothing turns on the different phrasings of the test of criminality in the three statutes. The Government concedes it had the burden of offering proof allowing a reasonable jury to be convinced beyond a reasonable doubt not merely that the financial statement was false or misleading in a material respect but that defendants knew it to be and deliberately sought to mislead.

While every criminal conviction is important to the defendant, there is a special poignancy and a corresponding responsibility on reviewing judges when, as here, the defendants have been men of blameless lives and respected members of a learned profession. See *United States* v. *Kahaner*, 317 F.2d 459, 467 (2 Cir.), *cert. denied*, 375 U.S. 836 (1963). This is no less true because the trial judge, wisely in our view, imposed no prison sentences. On the

other hand, as we observed in the *Kahaner* opinion, our office is limited to determining whether the evidence was sufficient for submission to the jury and, if so, whether errors prejudicial to the defendants occurred at the trial.[1]

I.

The trial hinged on transactions between Continental and an affiliate, Valley Commercial Corporation (hereafter "Valley"). The dominant figure in both was Harold Roth, who was president of Continental, supervised the day-to-day operations of Valley, and owned about 25% of the stock of each company.[2]

Valley, which was run by Roth out of a single office on Continental's premises, was engaged in lending money at interest to Continental and others in the vending machine business. Continental would issue negotiable notes to Valley, which would endorse these in blank and use them as collateral for drawing on two lines of credit, of $1 million each, at Franklin National Bank ("Franklin") and Meadowbrook National Bank ("Meadowbrook"), and would then

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[1] This is an appropriate point for rejecting defendants' argument that it was error to deny their request, opposed by the Government, for a non-jury trial. F.R. Cr. P. 23(a) conditions a non-jury trial on the Government's consent and "does not require that the Government articulate its reasons for demanding a jury trial." *Singer* v. *United States*, 380 U.S. 24, 37 (1965). As we held in *United States* v. *Abrams*, 357 F.2d 539, 549, *cert. denied*, 384 U.S. 1001 (1966), the complexity of the subject matter of the alleged offense does not alone entitle a defendant to a non-jury trial over the objection of the prosecutor. It is worth noting, although not critical, that the judge doubled the ordinary number of peremptory challenges, and that the jury was highly qualified.

[2] Two other large stockholders of Continental, Forbes and Hirsch, its counsel, Arthur Field, and Roth's father were the remaining principal stockholders of Valley.

transfer to Continental the discounted amount of the notes. These transactions, beginning as early as 1956, gave rise to what is called "the Valley payable." By the end of fiscal 1962, the amount of this was $1,029,475, of which $543,345 was due within the year.

In addition to the Valley payable, there was what is known as the "Valley receivable," which resulted from Continental loans to Valley. Most of these stemmed from Roth's custom, dating from mid-1957, of using Continental and Valley as sources of cash to finance his transactions in the stock market.[3] At the end of fiscal 1962, the amount of the Valley receivable was $3.5 million, and by February 15, 1963, the date of certification, it had risen to $3.9 million. The Valley payable could not be offset, or "netted," against the Valley payable since, as stated, Continental's obligations to Valley were in the form of negotiable notes which Valley had endorsed in blank to the two banks and used as collateral to obtain the cash which it then lent to Continental.

By the certification date, the auditors had learned that Valley was not in a position to repay its debt, and it was accordingly arranged that collateral would be posted. Roth and members of his family transferred their equity in certain securities to Arthur Field, Continental's counsel, as trustee to secure Roth's debt to Valley and Valley's debt to Continental. Some 80% of these securities consisted of Continental stock and convertible debentures.

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[3] From mid-1957 until January 1963 Continental thus advanced more than $16 million to Valley and Valley advanced more than $13 million to Roth. Of the latter sum the payment of approximately $6.5 million would have resulted in an overdraft in Valley's account but for the deposit of a Continental check on the same day.

The 1962 financial statements of Continental, which were dismal by any standard,[4] reported the status of the Valley transactions as follows:

ASSETS

Current Assets:

. . . .

Accounts and notes receivable:

. . . .

Valley Commercial Corp., affiliate (Note 2)	$2,143,335

. . . .

Noncurrent accounts and notes receivable:	
Valley Commercial Corp., affiliate (Note 2)	1,400,000

. . . .

LIABILITIES

Current Liabilities:

. . . .

Long-term debt, portion due within one year	$8,203,788

. . . .

Long-term debt (Note 7)

. . . .

Valley Commercial Corp., affiliate (Note 2)	486,130

. . . .

[4] The Company reported an operating loss of $867,000 and write-offs of some $3 million as compared with after-tax profits of $1,249,000 in the preceding year. Even with the inclusion of $2,143,335 of the total Valley receivable of $3,543,335, current assets, $20,102,504, barely exceeded current liabilities $19,043,262.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. The amount receivable from Valley Commercial Corp. (an affiliated company of which Mr. Harold Roth is an officer, director and stockholder) bears interest at 12% a year. Such amount, less the balance of the notes payable to that company, is secured by the assignment to the Company of Valley's equity in certain marketable securities. As of February 15, 1963, the amount of such equity at current market quotations exceeded the net amount receivable.

7. . . . . The amounts of long-term debt, including the portion due within one year, on which interest is payable currently or has been discounted in advance, are as follows:

. . . .

Valley Commercial Corp., affiliate	$1,029,475

The case against the defendants can be best encapsulated by comparing what Note 2 stated and what the Government claims it would have stated if defendants had included what they knew:

> 2. The amount receivable from Valley Commercial Corp. (an affiliated company of which Mr. Harold Roth is an officer, director and stockholder), which bears interest at 12% a year, was uncollectible at September 30, 1962, since Valley had loaned approximately the same amount to Mr. Roth who was unable to pay. Since that date Mr. Roth and others have pledged as security for the repayment of his obligation to Valley and its obligation to Continental (now $3,900,000,

against which Continental's liability to Valley cannot be offset) securities which, as of February 15, 1963, had a market value of $2,978,000. Approximately 80% of such securities are stock and convertible debentures of the Company.

Striking as the difference is, the latter version does not reflect the Government's further contention that in fact the market value of the pledged securities on February 15, 1963, was $1,978,000 rather than $2,978,000 due to liens of James Talcott, Inc. and Franklin for indebtedness other than Roth's of which defendants knew or should have known.

II.

Although the facts set forth up to this point were uncontroverted, there were some sharp disagreements concerning just what defendants knew and when they learned it. Issues of credibility, however, were for the jury, and we here set forth what the jury could premissibly have found the further facts to be.

Roth engaged the Lybrand firm as Continental's auditors in 1956. George Shegog was the partner in charge; Simon was "second partner" but had no responsibility save for the review of SEC filings. Upon Shegog's death, early in 1960, Simon became the partner in charge. Kaiser was first assigned to the Continental audit as "audit manager" for the 1961 audit. Fishman had been assigned to the Continental audit in 1957 as a young junior accountant; in 1962 he was promoted to be manager of the Continental audit for that year and Kaiser was retained as "second partner." The day-to-day supervision of the audit was the

responsibility of Richard McDevitt. As is usual, the structure was pyramidal in terms of time spent.

The Valley receivable had attracted attention early in Lybrand's engagment. In the late fall of 1958, Yoder, who was then manager of the Continental audit, discussed it with Roth. In a memorandum which was read by Fishman at the time and remained in the Lybrand audit files, Yoder recorded that during fiscal 1958 Continental had made net cash payments to Valley of $1,185,790, which "appeared to be for no other purpose than to provide Valley with cash." He recorded also that since September 30 Continental had made additional payments to Valley of $824,752 which were used "to finance the acquisition of capital stock of U. S. Hoffman Machine Corporation by Mr. Roth, or for loans by Valley to U. S. Hoffman." He also stated that he was informed that the receivable should be applied to notes of Continental and its subsidiaries which represented the Valley payable, and that he had agreed provided that the notes, which Valley had pledged as collateral for its borrowings from Franklin National Bank ("Franklin"), and Meadowbrook National Bank ("Meadowbrook"), were surrendered and made available for Lybrand's inspection. In a memorandum to Simon in November 1960, Yoder again discussed the Valley receivable, noting that the payments were frequent, in round amounts, and unaccompanied by written explanations. He observed that during the 1960 fiscal year the receivable had ranged from $695,000 in October 1959 to $398,000 in September 1960 with a high of $1,583,000 in April 1960.

In 1961 and 1962, the cash payments giving rise to the Valley receivable continued to be frequent, in round amounts, and without written explanation. Moreover, the balance in

the Valley receivable account characteristically was parabolic, rising after the end of one fiscal year and falling prior to the end of the next. The payments and repayments and the year-end balances for 1958-1962 are shown by the following table:

Year	*Advances to Valley (E125, 329a-376a)*	*Repayments by Valley (E37 through E49; E127 through E135)*	*Receivable at Year-End (E1 through E9)*
1958	$3,356,239	$2,583,172	$ –0–
1959	4,586,000	3,510,451	384,402
1960	2,511,000	2,670,500	397,996
1961	2,390,674	1,520,000	848,006
1962	4,708,000	1,986,500	3,543,335

Although the figure for the end of 1961 was more than double that at the end of the two preceding years, and had increased to about $2 million by December 31, 1961, prior to the certification date, the 1961 financial statement made no comment on the receivable, and none of the defendants asked whether Continental's directors had been informed of the transactions. Simon merely warned Roth that an examination of Valley's books would be required if the receivable at the end of fiscal 1962 was as large as at the end of 1961.

When Fishman visited Continental's office in early September 1962 in preparation for that year's audit, he was told that as of July 31 the Valley receivable had reached $3.6 million. He was told also that Continental was operating a check float in excess of $500,000 daily, that cash was "tighter than ever," and that Continental's Assistant Comptroller had spent most of July and August "juggling cash." Fishman reported this to Simon and Kaiser, noting that "all in all, it promises to be an 'interesting' audit."

The cash audit, conducted in early October 1962, showed how stringent cash had become. The $286,000 in hand on September 30 resulted only from thirty-day loans of $1.5 million from Franklin and Meadowbrook four days earlier. The Valley receivable was found to be around $3.5 million and Fishman told Roth in late October that this was so large that "there could be a problem with the yearend audit." In answer to a question by Fishman in November why Valley needed so much money, Kalan, Continental's Assistant Comptroller, said that "Roth needed the money to maintain the margin accounts on the U. S. Hoffman stock and bonds and the Continental stock and bonds."

Early in November Fishman met with Kaiser and reviewed the history of the Valley receivable. A memorandum of November 12 from Fishman to Kaiser, with a copy to Simon, "anticipated that September 30, 1962, Continental's balance sheet will show a net receivable from Valley of approximately $1,000,000 representing the excess of cash transfers to Valley over notes issued to Valley" and stated an intention to review the collectibility of the "net receivable" by examining "the latest available financial statements of Valley and other documentation."[5]

In December Fishman phoned Simon that the Valley receivable as of September 30 was about $3.5 million. Simon instructed Fishman to tell Roth that Lybrand would need the financial statements of Valley in order to evaluate the receivable's collectibility. Roth called Simon and said that Valley's audit was not yet finished and that the statements would be made available when it was. There were similar conversations during January 1963.

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[5] The Government notes that this is the first reference to a netting of the Valley payable against the Valley receivable—something which the defendants concede they knew to be impossible in view of Valley's having pledged Continental's notes as collateral.

Meanwhile, according to Roth, he had contacted Simon in December and said that although Valley had a net worth of $2 million, it was not in a position to repay its $3.5 million debt to Continental as it had lent him approximately the same amount which he was unable to repay. He suggested that he secure the indebtedness with his equity in stocks, bonds and other securities of Continental and Hoffman International if this would be acceptable. Roth called Simon some ten days later and received the latter's assent. On December 31 Roth placed Arthur Field, counsel for Continental, in charge of preparing the assignments.

Late in January 1963 Fishman visited Roth and showed him a draft of Note 2 substantially identical with the final form; he told Roth that Simon wanted to see him. They met in the Lybrand office on February 6. Defendants concede that at this meeting Roth informed Simon that Valley could not repay Continental and offered to post securities for the Valley receivable, and also to post as collateral a mortgage on his house and furnishings. Simon agreed that if adequate collateral were posted, a satisfactory legal opinion were obtained, and Continental's board approved the transactions, Lybrand could certify Continental's statements without reviewing Valley's, which still were not available. There was also a discussion of verification procedures. Simon determined that Roth, with a Lybrand employee listening on an extention phone, would call the various banks and brokers then holding Roth's securities to confirm the "amount of securities pledged and the amount due to them."

On February 12 Roth told Simon that Field had the collateral ready for verification. Simon instructed Kaiser to go to Field's office. Finding that Field had made the proposed assignments run to Valley, Kaiser called this "ridiculous"

and asked, "If the securities or if the cash equity gets back into Valley Commercial Corporation, what is to stop Harold Roth from taking the money out again as he did before?" On Kaiser's direction Field made the assignments run to himself as trustee for Valley and Continental. Field also discussed the available collateral and exhibited to Kaiser some handwritten notes prepared by Field and Miss Gans, secretary to Roth. These showed that the bulk of the collateral would consist of an equity in Continental stock and debentures. Kaiser made a number of calls having reference to this information and prepared notes of them which he later showed Simon; as developed in section V of this opinion, the Government alleges these demonstrated a complete encumbrance of all of Roth's securities held by Franklin, Meadowbrook and James Talcott, Inc. ("Talcott"). At Kaiser's request Field prepared a letter stating that $3.5 million in collateral was being posted and outlining the mechanics of the collateralization. On the following business day, Simon called to request that Field amend the letter to include an opinion that the collateral adequately secured the Valley receivable; the amended letter was sent on February 15 or 18. Meanwhile Field had informed Simon and Kaiser on February 13 that Continental's board of directors had disapproved of the loans to Valley.

On Friday, February 15, Kaiser assigned James Harris, a supervisor who had no previous connection with the Continental audit, to confirm the collateral. Kaiser explained the agreed procedure and introduced him to Roth and Miss Gans, but did not warn him of the possibility of encumbrances at Franklin, Meadowbrook and Talcott. The telephone calls began around 10 A.M. and continued until late afternoon when Miss Gans "started having difficulty in reaching some of the

people at some of these financial institutions." The calls ended, and Harris totalled the then quoted market price of the confirmed securities, substracted the indebtedness disclosed over the telephone, and arrived at an equity interest of some $3.1 million, this including an equity of $1.2 million in stock held at Franklin, Meadowbrook and Talcott. He telephoned Kaiser the results. Meanwhile Roth removed some $100,000 in odd securities from an office safe and offered them if Harris didn't have enough. The offer was declined.[6] The schedule was then delivered to McDevitt, who applied the closing market quotations of February 15; these reduced the value to $2,978,000.[7]

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[6] Kaiser subsequently prepared a memorandum of his telephone talk with Harris. This stated that Roth had exhibited a substantial number of loose securities to show that he could bring the collateral up over the promised $3.5 million and that Roth, over the telephone, asked for time to determine which securities would be included in the collateral. The Government claimed that this memorandum, which was paginated 79a and 79b as a result of having been inserted between pp. 79 and 80 of the audit files sometime after March 7, 1963, was a fabrication.

[7] Defendants claimed that they justifiably relied on Roth's promise that the collateral would include an additional $1,134,960 as follows:

Mortgage on Roth's house and furniture	$ 625,000
Loose stock certificates shown by Roth to Harris	100,000
Equity in U. S. Hoffman Machinery Corp. stock	173,000
Securities listed on schedule shown by Field to Kaiser but not confirmed by Harris	236,960
	$1,134,960

They relied also on Field's opinion letter stating that the receivable was secured by an equity in securities having a value of $3,5 million. However, the first two items were never included in the collateral assigned to Field as trustee. Harris left the U. S. Hoffman Machinery stock out of his list because it had been delisted and had only a nominal quotation of 43¢ per share. Some institutions listed by Field as holding securities were never checked by Harris, but in light of the inaccuracies in Field's list which were revealed by Harris' check, any attempt to evaluate the holdings at these institutions would be highly speculative.

The three defendants met at Continental's plant on Saturday, February 16, and prepared a printer's draft of the financial statements.[8] Simon telephoned Roth and discussed the proposed statement, including Note 2. In the course of the conversation he requested payment of some $13,000 still owing for the 1961 audit. On Roth's instructions Kalan gave Simon a check, saying "This is going to bounce."

On Monday, February 18, Simon reviewed a printer's proof of the statements. At that time, for reasons which were not developed at trial but are now conceded to be proper, he moved from noncurrent into current assets $1,433,104, representing a receivable from the sale of certain vending routes. At the same time, he dropped from current assets to noncurrent assets some $1,400,000 of the Valley receivable, which Roth caused to be refinanced by Valley's issuance of long-term notes in that amount. Although Simon testified that he made this change solely because of the issuance of the notes, in which he had no part, Roth testified that Simon had earlier told him that some of the $3.5 million Valley receivable would have to go "below the line"—i.e., into noncurrent assets.

The financial statements were mailed as part of Continental's annual report on February 20. By that time the market value of the collateral had declined some $270,000 from its February 15 value. The value of the collateral fell

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[8] Fishman's handwritten draft of the liability side of the balance sheet showed the current and noncurrent portions of the Valley payable separately from other current and noncurrent liabilities. In revising this draft, Simon included the current portion in a lump-sum figure for the total portion of long-term debt payable within a year; however, a reader could determine the current portion by subtracting the long-term debt to Valley from the total shown in Note 7.

an additional $640,000 on February 21. When the market reopened on February 25, after the long Washington's birthday recess, it fell another $2 million and was worth only $395,000. The same day a Continental check to the Internal Revenue Service bounced. Two days later the Government padlocked the plant and the American Stock Exchange suspended trading in Continental stock. Investigations by the SEC and bankruptcy rapidly ensued.

III.

The defendants called eight expert independent accountants, an impressive array of leaders of the profession. They testified generally that, except for the error with respect to netting, the treatment of the Valley receivable in Note 2 was in no way inconsistent with generally accepted accounting principles or generally accepted auditing standards, since it made all the informative disclosures reasonably necessary for fair presentation of the financial position of Continental as of the close of the 1962 fiscal year. Specifically, they testified that neither generally accepted accounting principles nor generally accepted auditing standards required disclosure of the make-up of the collateral or of the increase of the receivable after the closing date of the balance sheet, although three of the eight stated that in light of hindsight they would have preferred that the make-up of the collateral be disclosed. The witnesses likewise testified that disclosure of the Roth borrowings from Valley was not required, and seven of the eight were of the opinion that such disclosure would be inappropriate. The principal reason given for this last view was that the balance sheet was concerned solely with presenting the fi-

nancial position of the company under audit; since the Valley receivable was adequately secured in the opinion of the auditors and was broken out and shown separately as a loan to an affiliate with the nature of the affiliation disclosed, this was all that the auditors were required to do. To go further and reveal what Valley had done with the money would be to put into the balance sheet things that did not properly belong there; moreover, it would create a precedent which would imply that it was the duty of an auditor to investigate each loan to an affiliate to determine whether the money had found its way into the pockets of an officer of the company under audit, an investigation that would ordinarily be unduly wasteful of time and money. With due respect to the Government's accounting witnesses, an SEC staff accountant, and, in rebuttal, its chief accountant, who took a contrary view, we are bound to say that they hardly compared with defendants' witnesses in aggregate auditing experience or professional eminence.

Defendants asked for two instructions which, in substance, would have told the jury that a defendant could be found guilty only if, according to generally accepted accounting principles, the financial statements as a whole did not fairly present the financial condition of Continental at September 30, 1962, and then only if his departure from accepted standards was due to willful disregard of those standards with knowledge of the falsity of the statements and an intent to deceive. The judge declined to give these instructions. Dealing with the subject in the course of his charge, he said that the "critical test" was whether the financial statements as a whole "fairly presented the financial position of Continental as of September 30, 1962, and

whether it accurately reported the operations for fiscal 1962." If they did not, the basic issue became whether defendants acted in good faith. Proof of compliance with generally accepted standards was "evidence which may be very persuasive but not necessarily conclusive that he acted in good faith, and that the facts as certified were not materially false or misleading." "The weight and credibility to be extended by you to such proof, and its persuasiveness, must depend, among other things, on how authoritative you find the precedents and the teachings relied upon by the parties to be, the extent to which they contemplate, deal with, and apply to the type of circumstances found by you to have existed here, and the weight you give to expert opinion evidence offered by the parties. Those may depend on the credibility extended by you to expert witnesses, the definiteness with which they testified, the reasons given for their opinions, and all the other facts affecting credibility, . . ."

Defendants contend that the charge and refusal to charge constituted error. We think the judge was right in refusing to make the accountants' testimony so nearly a complete defense. The critical test according to the charge was the same as that which the accountants testified was critical. We do not think the jury was also required to accept the accountants' evaluation whether a given fact was material to overall fair presentation, at least not when the accountants' testimony was not based on specific rules or prohibitions to which they could point, but only on the need for the auditor to make an honest judgment and their conclusion that nothing in the financial statements themselves negated the conclusion that an honest judgment had been made.

Such evidence may be highly persuasive, but it is not conclusive, and so the trial judge correctly charged.

Defendants next contend that, particularly in light of the expert testimony, the evidence was insufficient to allow the jury to consider the failure to disclose Roth's borrowings from Valley, the make-up of the collateral, or the post-balance sheet increase in the Valley receivable. They concentrate their fire on what they characterize as the "primary, predominant and pervasive" issue, namely the failure to disclose that Continental's loans to Valley were not for a proper business purpose but to assist Roth in his personal financial problems. It was "primary, predominant and pervasive" not only because it was most featured by the prosecution but because defendants' knowledge of Roth's diversion of corporate funds colored everything else. We join defendants' counsel in assuming that the mere fact that a company has made advances to an affiliate does not ordinarily impose a duty on an accountant to investigate what the affiliate has done with them or even to disclose that the affiliate has made a loan to a common officer if this has come to his attention. But it simply cannot be true that an accountant is under no duty to disclose what he knows when he has reason to believe that, to a material extent, a corporation is being operated not to carry out its business in the interest of all the stockholders but for the private benefit of its president. For a court to say that all this is immaterial as a matter of law if only such loans are thought to be collectible would be to say that independent accountants have no responsibility to reveal known dishonesty by a high corporate officer. If certification does not at least imply that the corporation has not been looted by insiders so far

as the accountants know, or, if it has been, that the diversion has been made good beyond peradventure (or adequately reserved against) and effective steps taken to prevent a recurrence, it would mean nothing, and the reliance placed on it by the public would be a snare and a delusion. Generally accepted accounting principles instruct an accountant what to do in the usual case where he has no reason to doubt that the affairs of the corporation are being honestly connected. Once he has reason to believe that this basic assumption is false, an entirely different situation confronts him. Then, as the Lybrand firm stated in its letter accepting the Continental engagement, he must "extend his procedures to determine whether or not such suspicions are justified." If as a result of such an extension or, as here, without it, he finds his suspicions to be confirmed, full disclosure must be the rule, unless he has made sure the wrong has been righted and procedures to avoid a repetition have been established. At least this must be true when the dishonesty he has discovered is not some minor peccadillo but a diversion so large as to imperil if not destroy the very solvency of the enterprise.

On this dominating issue of Roth's diverting corporate funds we do not have a case where the question is whether accountants may be subjected to criminal sanction for closing their eyes to what was plainly to be seen. Fishman was proved to have known what was going on since 1958, Simon must have had a good idea about it from the spring of 1960 when Roth informed him that he had borrowed $1,000,000 from investment bankers to make a repayment to Valley, and the jury could infer that Kaiser also was not unaware. If Roth's testimony was believed, the defendants knew almost all the facts from December 1962. In any event

they concede knowledge prior to the certification. Beyond what we have said, Field testified that at a meeting in February 1963 before the statements were certified, he, Simon and Kaiser discussed "how was it possible for a man like Harold Roth . . . for a man like that to go wrong and to take out this money through the circuitous method of having it first go into Valley and then to withdraw it immediately by himself . . . ." The jury could reasonably have wondered how accountants who were really seeking to tell the truth could have constructed a footnote so well designed to conceal the shocking facts. This was not simply by the lack of affirmative disclosure but by the failure to describe the securities under circumstances crying for a disclosure and the failure to press Roth for a mortgage on his house and furnishings, description of which in the footnote would necessarily have indicated the source of the collateral and thus evoked inquiry where the money advanced to Valley had gone.

Turning to the failure to describe the collateral, defendants concede that they could not properly have certified statements showing the Valley receivable as an asset when they knew it was uncollectible. That was why Roth proposed collateralization and they accepted it. As men experienced in financial matters, they must have known that the one kind of property ideally unsuitable to collateralize a receivable whose collectibility was essential to avoiding an excess of current liabilities over current assets and a two-thirds reduction in capital already reduced would be securities of the very corporation whose solvency was at issue—particularly when the 1962 report revealed a serious operating loss. Failure to disclose that 80% of the "marketable securities" by which the Valley receivable was said to

be "secured"[9] were securities of Continental was thus altogether unlike a failure to state how much collateral were bonds or stocks of General Motors and how much of U.S. Steel. Indeed one of the defense experts testified that disclosure would be essential if Continental stock constituted more than 50% of the collateral. Beyond this, we are not here required to determine whether failure to reveal the nature of the collateral would have been a submittable issue if the Valley receivable had constituted an advance made for a legitimate business purpose. Defendants' conduct had to be judged in light of their failure to reveal the looting by Roth. Since disclosure that 80% of the securities were Continental stock or debentures would have led to inquiry who could furnish so much, the jury could properly draw the inference that the failure to reveal that the bulk of the pledged securities was of the one sort most inappropriate to "secure" the Valley receivable, rather than being a following of accepted accounting principles, was part of a deliberate effort to conceal what defendants knew of the diversion of corporate funds that Roth had perpetrated.

We are likewise unimpressed with the argument that defendants cannot be charged with criminality for failure to disclose the known increase in the Valley receivable from $3.4 to $3.9 million. Here again the claim that generally accepted accounting practices do not require accountants to investigate and report on developments since the date of the statements being certified has little relevance. Note 2 stated "As of February 15, 1963, the amount of such

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[9] A Lybrand practice bulletin warned against use of the word "secured" since the ordinary reader would regard this as meaning "fully secured."

equity at current market quotations exceeded the net amount receivable." This means the net amount receivable as of February 15. If the receivable remained at the $3.9 million level it had attained at December 31, 1962, and there is nothing to indicate its reduction, the collateral of $2.9 million verified by Harris barely equalled even the "net" receivable, since the collateral, supplied long after September 30, 1962, although this also was not disclosed, concededly was security for advances after September 30 as well as before. The jury was thus entitled to infer that the failure to reveal the increase in the Valley receivable was part of an effort to create an appearance of collectibility which defendants knew to be false. Indeed one of the defense experts agreed that the increase in the receivable was a material event that required disclosure in the absence of sufficient collateral. Moreover, this issue, like the others, must be considered in context. The jury could find that failure to reveal the known increase in the Valley receivable, rather than being motivated by adherence to accepted accounting principles, was due to fear that revelation of the increase would arouse inquiry why a company in the desperate condition of Continental would go on advancing money to an affiliate and thus lead to discovery of Roth's looting.

IV.

Defendants properly make much of the alleged absence of proof of motivation. They say that even if the Government is not bound to show evil motive, and we think it is not, see *Pointer* v. *United States*, 151 U.S. 396 (1894), lack of evidence of motive makes the burden of proving criminal intent peculiarly heavy and the Government did not discharge this.

It is quite true that there was no proof of motive in the form usual in fraud cases. None of the defendants made or could make a penny from Continental's putting out false financial statements. Neither was there evidence of motive in the sense of fear that telling the truth would lose a valuable account. Continental was not the kind of client whose size would give it leverage to bully a great accounting firm, nor was it important to the defendants personally in the sense of their having brought in the business. One would suppose rather that the Continental account had become a considerable headache to the Lybrand firm generally and to the defendants in particular; they could hardly have been unaware of the likelihood that the many hours the firm had devoted to the 1962 audit would not be compensated and that another might never occur. Ordinary commercial motivation is thus wholly absent.

The Government finds motive in defendants' desire to preserve Lybrand's reputation and conceal the alleged dereliction of their predecessors and themselves in former years—the failure to advise Continental's board of directors of Roth's role in creating the Valley receivable, see N. Y. Stock Corporation Law §59; the failure to expand the scope of the audit for those years to determine the nature and collectibility of the Valley receivable, despite the injunction in a well-known text originally authored by one of the founders of the Lybrand firm, that receivables from affiliates must be scrutinized carefully to determine they "are what they purport to be";[10] and the certification of the 1961 statements despite Simon's warning to Roth that a further increase in the receivable

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[10] Montgomery, Auditing, 180. Simon had contributed to a revision of this standard work.

would necessitate an examination of Valley's books. The apparent failure of the defendants to consult with the Lybrand executive committee, or with the partner in the firm to whom "problems" in audits were supposed to be referred, on what would seem highly important policy questions concerning the 1962 audit adds force to these arguments.

The main response is that if the defendants had wanted to cover up any past delinquencies they would not have insisted on financial statements so dismal in other respects. It is alleged that defendants demanded certain adjustments which good accounting practice permitted but did not require. It is said also that defendants must have known the statements were so unfavorable, even with the limited disclosure in Note 2, that Continental was bound to fold and a full investigation would follow. The argument is impressive but not dispositive. Defendants may have harbored the illusion that the dexterity of Continental's treasurer in "juggling cash" would enable it to survive. Moreover, men who find themselves in a bad situation of their own making do not always act with full rationality.

Even if there were no satisfactory showing of motive, we think the Government produced sufficient evidence of crimnal intent. Its burden was not to show that defendants were wicked men with designs on anyone's purse, which they obviously were not, but rather that they had certified a statement knowing it to be false. As Judge Hough said for us long ago, "while there is no allowable inference of knowledge from the mere fact of falsity, there are many cases where from the actor's special situation and continuity of conduct an inference that he did know the untruth of what he said or wrote may legitimately be drawn." *Bentel v. United*

States, 13 F.2d 327, 329, *cert. denied,* 273 U.S. 713 (1926). See also *Aiken* v. *United States,* 108 F.2d 182, 183 (4 Cir. 1939). Moreover, so far as criminal intent is concerned, the various deficiencies in the footnote should not be considered in isolation. Evidence that defendants knowingly suppressed one fact permitted, although it surely did not compel, an inference that their suppression of another was likewise knowing and willful.

In addition to all that has been said on this score in the previous section of this opinion, a strong indication of knowing suppression lay in the evidence concerning the erroneous reduction of the Valley receivable by the $1 million of notes payable. Defendants say that this was mere negligence; that, beginning with Fishman's memorendum of November 12, 1962, they were "thinking net." But the jury was not bound to accept this. Even if the jury believed that Fishman had negligently slipped into error in November 1962,[11] despite his peculiar awareness of the impossibility of netting, which it was not required to do, it truly taxed credulity to suppose that, with all the attention that was given to the Valley receivable over the next three months, none of these defendants, experienced in the business of Continental, ever mentioned to the others that the critical figure was not the net receivable but the gross, as indeed the body of the financial statements showed, so that $3 million of collateral would not secure the receivable. Indeed Simon and Kaiser swore

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[11] The memorandum of November 12 is peculiar in that it refers to the anticipated net figure as approximately $1 million although the gross receivable at July 30, 1962 was known to be $3.6 million and the payable to run to some $1 million yearly. Fishman hadn't "the slightest idea" where the $1 million net figure came from.

in depositions taken in a civil suit brought by Continental's bankruptcy Trustee and before the grand jury that they had known in February 1963 that the Continental notes were pledged so that netting was impossible, and made the implausible contention, as did Fishman in his grand jury testimony, that Note 2 had not netted. Defendants' attempt to escape from all this by alleging that they learned of the pledges of the Continental notes only in discussions with a Valley employee in May 1963, may have made matters worse for them with the jury rather than better. For the employee denied the conversation and the story was inconsistent with the failure to net in the financial statements themselves and with other evidence.

The Government furnished added evidence of criminal intent in the shape of conflicting statements by the defendants and contradictions by other witnesses. Simon and Fishman had testified before the Referee in Continental's bankruptcy proceedings that they had discussed, together with Kaiser, whether disclosure need be made of the nature of the collateral, and had rejected this as unnecessary. Yet Simon testified at trial that no consideration had been given to this and Fishman could not recall any discussion. Simon and Fishman swore to the Referee that they had not known of Roth's borrowings from Valley until March 1963. On the other hand, Fishman admitted before the grand jury that he had known of them as early as 1958; Roth testified to telling Simon about them in December 1962; all the defendants now admit they were fully informed before the certification in February 1963; and counsel for Continental's trustee testified that Simon had admitted knowing the facts "a long time" before that. When we add the delay in get-

ting at the critical matter of the Valley receivable, the failure to follow up Roth's offer of a mortgage on his house and furniture, and the last minute changes in the balance sheet, we find it impossible to say that a reasonable jury could not be convinced beyond a reasonable doubt that the striking difference between what Note 2 said and what it needed to say in order to reveal the truth resulted not from mere carelessness but from design. That some other jury might have taken a more lenient view, as the trial judge said he would have done, is a misfortune for the defendants but not one within our power to remedy.

V.

In this last section of the opinion we will treat defendants' arguments concerning securities of Roth held by Franklin and Talcott, and the judge's handling of questions by the jury on this and another matter.

Kaiser's notes of his interview of February 12, 1963, with Field, which he showed to Simon on the next day, contained the following:

"Harold Roth	[Subtotal]		$1,293
	645,000 shs. Cont. Vend. common Market		
	2-11-63—4⅛	$2,660M	
	24,000 shs. Hoffman Int'l common Market		
	2-11-63—3⅝	87	
		$2,747M	

Above is pledged as follows:

Talcott & banks primary security is third party paper	James Talcott—200,000 shs. Cont. Vend. com. securing Cont. Vend. & U. S. Hoffman borrowing	
	Franklin Natl. & Meadowbrook Banks	
	445,000 shs. Cont. Vend. common 24,000 shs. Hoffman Int. com.	securing
	Valley borrowing (1MM from each bank)	
	Valley will give Cont. Vend. a letter stating that upon payment of Talcott & Bank borrowing, above stock will not be disposed of except to repay Valley's note to Cont. Vend.	2,747
		$4,040"

Neither Kaiser nor Field communicated to Harris this indication that the securities held by Franklin, Meadowbrook and Talcott were subject to liens arising from borrowings other than Roth's. When Roth called Meadowbrook, with Harris listening on an extension phone, the bank stated that it held 23,600 shares of Hoffman International stock worth $80,000 which was "Security on Valley obligation," as it later confirmed in writing. Although Harris recorded this on his worksheet, he nevertheless included the $80,000 in the collateral, which defendants admit to have been an error although assertedly an inconsequential one. Franklin said it held 144,484 shares of U. S.

Hoffman, 24,411 of Hoffman International and 585,600 of Continental against a loan of $1,525,000 to Roth, as it subsequently confirmed in writing. Harris' computation, as later revised by McDevitt, included an equity of $900,000 in these securities. There was an erasure, innocent on defendants' view, in the "Comments" column of Harris' worksheets in regard to Franklin. The worksheets with respect to Talcott showed a holding of 67,000 Continental shares as "Collateral on indebtedness of Con. Vend. Mach. to Hoffman Mach." Harris included these shares at $270,000, their full market value. Harris' report did not show to whom he had talked at Talcott, and no written confirmation was received.[12]

The Government was allowed to prove by internal records of Franklin that the securities there constituted collateral for Valley's debt of $944,269 in addition to Roth's personal debt. It was also allowed to prove by internal records of Talcott that Roth had pledged 25,000 Continental shares to secure the payment of Hoffman International notes discounted by U. S. Hoffman and 40,000 shares to guarantee loans by Talcott to Crescent Vending, a total liability exceeding $1 million. The court made clear to the jury that the contention was not that defendants had seen the Franklin or Talcott records but rather that "they should have known, and shut their eyes to the inquiry." Defendants contend that even this limited use of the records was improper.

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[12] In his deposition in the Trustee's suit Harris had testified to a vague recollection that he had included these securities because Roth had wanted them included and had indicated an intention to replace them at Talcott with other collateral, to wit, his home.

We have little difficulty in sustaining the court's ruling with respect to Kaiser and Simon. Kaiser's interview with Field, the notes of which were shown to Simon, indicated the unavailability of the securities held at the two banks and Talcott. The jury could take the failure to pass this information on to Harris and the acceptance of his schedules without further inquiry despite their confirmation of the unavailability of the stock at Meadowbrook and Talcott to be evidence of willingness to be satisfied with anything that would create the appearance of adequate security. Although defendants contend that the force of Kaiser's notes of February 12 was dissipated by another schedule given by Field allegedly on February 14 (which the Government disputes), making no reference to liens arising from indebtedness other than Roth's, this was a matter for the jury. The effect of Franklin's confirmation is dissolved if the only question propounded to it was the amount of Roth's indebtedness; furthermore the jury was not required to accept the innocent explanation of the erasure. As to Kaiser and Simon the Government was thus entitled to show, under proper instructions, what proper inquiry would have revealed. On the other hand the evidence would have been admissible against Fishman only on the basis that, his membership in a conspiracy having been sufficiently shown, further evidence of the derelictions of the other conspirators was also admissible against him. While he would have been entitled to an instruction making that clear, none was sought.

During the evening after the case was submitted, the jury, which had been conferring for several hours, reported it was deadlocked, but the judge instructed it to deliberate

further. Before leaving the courtroom it then asked three questions:

> " 'Is there evidence, undisputed or otherwise that the 2.9 million collateral had prior liens?'
>
> "That is question No. 1.
>
> "Question No. 2:
>
> " 'Where did the proceeds of the home and furnishings mortgage go?'
>
> "Now 3:
>
> " 'Was there testimony to the effect that the $2,900,000 was reduced to $1,700,000?' "

After an endeavor to answer these had led to extended colloquy, the judge dismissed the jury for the night, heard counsel again the next morning, and then addressed the jury.

Instead of answering the first question categorically, the judge made a painstaking summary of all the evidence in which he developed the conflicting contentions and the inferences the jury could draw or not as it saw fit. With a single exception discussed in the margin,[13] defendants

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[13] Defendants contend the judge should have instructed that the Continental shares pledged with Talcott were good collateral as a matter of law despite Talcott's lien on them to secure what Kaiser's schedule reflected as a Continental note to U. S. Hoffman. The argument, which the judge fairly presented to the jury, is that if Continental paid the note, it would receive the collateral, whereas if it did not pay, it would get the advantage of application of the collateral in reduction of the note without Roth's being subrogated to Talcott's claim for that amount. However, the jury could find that the prospect of Continental's paying the note was remote and that the availability of collateral to reduce a liability of Continental did not make it proper security for the collectibility of the Valley receivable. Furthermore, the true facts, revealed in Harris' worksheets, were that the stock was security for a liability not of Continental but of two other companies.

make no criticism of the summary, and we can find no basis for any. The judge then said he would defer answering the third question because he did not understand the meaning of the words "reduced to." While it might have been better if the judge had simply referred back to what he had already said, we see no error of which the defendants can complain. The judge's detailed answer to the first question provided the best possible assistance with respect to the third, and he could not properly have given the categorical negative answer the defendants desired.[14]

We likewise see no basis for criticizing the judge's answering of the second question by reading to the jury the relevant testimony of Simon and Field. This made clear that, although Roth had assigned the mortgages to Valley and Continental ultimately received them, they were not included in the collateral for the payment of the Valley receivable which constituted the basis for defendants' assertion of adequate collateralization.

We have carefully reviewed the few other arguments made by the defendants but do not consider them of sufficient importance to justify prolonging this already long opinion. This was a trial bitterly but honorably fought,

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[14] Defendants likewise complain that the judge did not develop that there may have been collateral in addition to the $2.9 million reflected in Harris' worksheets and McDevitt's revision, see fn. 7. But the questions were framed by the jury and defendants made no request for the judge to deal with this point.

by exceedingly capable and well-prepared counsel, before an able judge experienced in complicated litigation and a highly intelligent jury. Finding that the evidence was sufficient for submission to the jury and that no legal errors were committed, we must let the verdict stand.

Affirmed.

APPENDIX B

Opinion of Mansfield, *J.*

APPENDIX B

Opinion of Mansfield, *J.*

[R. 44]

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,

Plaintiff,

—against—

CARL SIMON, HAROLD ROTH, ROBERT KAISER and MELVIN FISHMAN,

Defendants.

MANSFIELD, D.J.

This memorandum decision disposes of defendants' motion for a judgment of acquittal or, in the alternative, for a new trial which was argued on September 6, 1968.

For the most part the motion raises issues of fact that have been decided by the jury adversely to the defendants, or assumes findings favorable to themselves on certain issues as to which there was contrary evidence. Although the Court, had it been the trier of the fact, would probably have found sufficient doubt to warrant acquittal, at this stage it must view the evidence, the credibility of the witnesses, and the inferences drawn, most favorably to the Government, and it would be justified in granting the motion only if it concluded that reasonable men could not conclude beyond a reasonable doubt that the defendants are guilty of the charges asserted against them, *United States* v. *de Sesto*,

329 F. 2d 929 (2d Cir.), *cert. denied,* 377 U.S. 979 (1964), or that there was lack of substantial evidence to support the verdict, *United States* v. *Chas. Pfizer & Co.,* 281 F. Supp. 837 (S.D.N.Y. 1968); *United States* v. *Robinson,* 71 F. Supp. 9 (D.D.C. 1947); *United States* v. *Nystrom,* 116 F. Supp. 771 (W.D. Pa. 1953).

The fraud charge in the indictment related to the $3,543,335 shown in the financial statement of Continental Vending Machine Corporation ("Continental" herein) for the fiscal year ending September 30, 1962 as an asset in the form of an account receivable due from Valley Commercial Corporation ("Valley" herein), its affiliate, representing approximately 11% of Continental's assets. The defendants were charged with concealing the fact that Roth was the real beneficiary, or indirect borrower, of a substantial portion of large amounts advanced by Continental to Valley over the period 1958-62, resulting in a balance due from him to Valley of over $3 million as of the date of Continental's statement, and with making various statements in Footnote 2 to the Continental report that would mislead readers ino believing that the "Valley receivable" shown as an asset on Continental's statement, was adequately secured when in fact the collateral was inadequate.* More specifically it is charged that Footnote 2 fraudulently represented that the receivable could be netted by offsetting a

* Footnote 2 stated: "2. The amount receivable from Valley Commercial Corp. (an affiliated company of which Mr. Harold Roth is an officer, director and stockholder) bears interest at 12% a year. Such amount, less the balance of the notes payable to that company, is secured by the assignment to the Company of Valley's equity in certain marketable securities. As of February 15, 1963, the amount of such equity at current market quotations exceeded the net amount receivable."

Valley payable in the sum of approximately $1 million which would have the effect of reducing Valley's debt to Continental from $3.5 million to approximately $2.5 million. It is further charged that Footnote 2 fraudulently represented that the Valley receivable was adequately secured by assignment of securities, when in fact the securities were inadequate and consisted for the most part of stocks and debentures of Continental itself, the value of which depended on the collectibility of the receivable being secured. It is also charged that although the footnote referred to the security as being adequate on February 15, 1963, it concealed the fact that the receivable had increased from $3.5 million on September 30, 1962 to almost $4 million on February 15, 1963.

With respect to the alleged concealment that Roth, Continental's President, was the indirect borrower of funds loaned to Valley, there was evidence permitting the jury to find that the defendants knew at an early stage that Roth was the indirect borrower of the funds advanced by Continental to Valley. Defendants offered a great deal of evidence, including testimony by a group of distinguished experts in the accounting profession, to the effect that generally accepted auditing standards and accounting principles did not require such disclosure on Continental's financial statement and that such disclosure would have been inappropriate, it being sufficient to refer to the receivable as due from "an affiliate," which would indicate that the transaction was not an arm's length one. The Government, on the other hand, offered expert testimony to the effect that indirect loans in such substantial amounts

to Continental's own President constituted material facts that should have been disclosed by the defendants as in Continental's financial statement.

Thus an issue of fact was presented for resolution by the jury and since there was evidence permitting the jury to find that the defendants knew that Roth was the indirect borrower of the funds giving rise to the $3.5 million Valley receivable, which might affect its collectibility, this Court cannot conclude that there was insufficient evidence to support a finding by the jury that it represented a material fact concealed by the defendants. In resolving that issue the jury was instructed that it was entitled to weigh and consider the extensive expert testimony adduced with respect to generally accepted auditing standards and accounting principles or practice. Defendants and the American Institute of Certified Public Accountants (appearing as amicus curiae) urge that the proof established that these standards and principles did not require such disclosure and that it was error for the Court to refuse to charge that adherence to such standards and principles was a complete defense. Overlooking for the moment the fact that there was contrary expert testimony given by Messrs. Pardee and Barr, the Court adheres to its view, which was expressed in instructions to the jury, that the jury was entitled, in determining whether or not a defendant knowingly concealed a material fact, to consider and weigh proof as to generally accepted auditing standards and accounting principles in effect at the time of their action, along with all of the other proof in the case, but that proof of such standards and principles is not conclusive on the issue of fraud.

Even if the Government failed to prove beyond a reasonable doubt the concealment of Roth as the indirect borrower, the jury's decision must stand if there was substantial proof supporting the charge that the statements made in Footnote 2 with respect to collateralizaion of the Valley receivable were fraudulent. Defendants contend, however that once it is assumed that the Government failed to prove concealment by them in prior years (1958-61) of Roth as the ultimate beneficiary of the funds advanced by Continental to Valley, it failed to establish any motive for the defendants to make false or misleading statements in Continental's 1962 financial report with respect to collateralization of the Valley receivable. Furthermore, the defendants offered evidence of lack of any such motive, including their rejection of Continental's proposal that the 1962 statement give a much more favorable picture of its financial status in other respects than what was actually shown, their insistence that Continental's heavy losses be revealed, and the fact that they did not stand to gain from any misrepresentations, but in fact were not paid their bill for the prior year's audit, amounting to $13,000.

Motive is not an element of the crimes alleged in the indictment. *Pointer* v. *United States,* 151 U.S. 396 (1894); *United States* v. *Spaeth,* 152 F. Supp. 216 (N.D. Ohio), *aff'd.,* 254 F. 2d 924 (6th Cir.), *cert. denied,* 358 U.S. 831 (1958); *United States* v. *Schneiderman,* 106 F. Supp. 906 (S.D. Cal.), affd. sub. nom. *Yates* v. *United States,* 225 F. 2d 146 (9th Cir.), *rev'd on other grounds,* 354 U.S. 298 (1957). However, as the Court instructed the jury, the existence or absence of motive is an important factor in determining whether or not the elements have been established. There

was evidence entitling the jury to infer that the defendants were motivated by a desire to avoid charges of professional incompetence and negligence based on failure to call to the attention of the Board the nature and extent of Roth's misuse of Continental's funds. See *Everett* v. *Phillips*, 288 N.Y. 227, 43 N.E. 2d 18 (1942). The evidence introduced as to lack of motive was all brought to the jury's attention, argued at length, and apparently weighed by it.

Turning to the charge that the statements in Footnote 2 with respect to collateralization of the Valley receivable were fraudulent, it was undisputed that the Valley receivable and Valley payable shown on Continental's financial statement could not be netted or offset against each other because the Continental notes discounted by Valley were no longer in its possession but had been pledged with the Meadowbrook and Franklin National Banks so that these banks, assuming they were holders in due course, would be entitled to collect the indebtedness represented by the notes, and not Valley. The statement in Footnote 2 to the effect that the receivable "*less* the balance of the notes payable to [Valley], is secured by the assignment to the company of Valley's equity in certain marketable securities" (emphasis supplied) and that "as of February 15, 1963, the amount of such equity at current market quotations exceeded the *net amount receivable*" (emphasis supplied) erroneously implied that netting was proper, which would reduce the net balance due from Valley from $3.5 million to $2.5 million. Although there was a great deal of evidence looking both ways on the question of whether the defendants were, at the time when they prepared the financial statement, conscious of facts showing the impropriety of the implication with re-

spect to netting, there was sufficient evidence to permit the jury to infer such consciousness, the issue essentially turning on the credibility and weight to be according to the testimony.

The defendants have all along contended that even if the footnote might have misled a reader into believing that netting was possible, it was immaterial for the reason that the collateral was sufficient to secure the collectibility of the $3.5 million receivable. However, despite sharp conflicts in the extensive evidence adduced as to the amount and value of the collateral, there was sufficient evidence to permit the jury to find that the collateral was inadequate and that the defendants had knowledge of such inadequacy. Although Roth made an assignment of his equity in shares and debentures of Continental itself, which was calculated as worth approximately $2.9 million, and assurances were given that additional securities and a mortgage on Roth's home and furnishings would increase the collateral to over $3.5 million, an analysis of the securities by various witnesses provided evidence entitling the jury to conclude that the assigned equities were worth substantially less than the amounts attributed to them and that the defendants had knowledge of this fact. In this connection the defendants contend that the Court erred in submitting to the jury as an issue of fact the question of whether the defendants had the right to list as part of the collateral 67,000 shares of Continental stock* owned by Roth and worth approximately

* Ultimately it appeared that the number of such shares was 65,000 not the 67,000 shown in the schedule of collateral prepared by the defendants. It also was conceded that the same schedule erroneously included as collateral 23,600 shares of Hoffman International stock with the Meadowbrook National Bank which had been pledged to secure a Valley obligation.

$268,000, which had previously been pledged by Roth to secure Continental's notes (to U.S. Hoffman Machinery) in the sum of about $1 million. Defendants have argued that the Court should have instructed that as a matter of law this stock had collateral value equal to its market value for the reason that if Continental paid its notes, the stock would be freed to secure the Valley receivable, whereas if the shares were foreclosed to satisfy Continental's obligations on these notes, Continental would acquire value to the extent of Roth's right of subrogation against it which could be offset against the Valley receivable. The flaw in this argument is that it overlooks the hopeless financial condition of both Roth and Continental at the time and it would substitute as collateral a doubtful right of offset in place of what was represented in Continental's financial statement to be "equity in certain marketable securities." The proof showed that since Continental was unable to pay the $1 million owed to Talcott (on Continental's notes), which far exceeded the value of the 67,000 Continental shares pledged to secure that debt (worth $268,000) there was no remaining "equity" in the securities available to Continental. Moreover, assuming that Roth would have a right of subrogation against Continental if the security were foreclosed, Continental would also have a counterclaim against Roth, probably in a far greater amount, based on Roth's breach of his fiduciary duty in causing Continental to make indirect loans in very substantial amounts via Valley to himself without approval of Continental's Board of Directors. See *Everett* v. *Phillips,* 288 N.Y. 227, 43 N.E. 2d 18 (1942), a derivative suit against directors to recover amounts owed to a corporation under common control, wherein the Court stated:

> "To establish his cause of action the plaintiff must show that the individual defendants in causing the Empire Power Corporation to loan the moneys to the Long Island Lighting Company and in failing to demand payment of such loans as they become due, have acted in disregard of the duties they owe Empire Power Corporation and that Empire Power Corporation has suffered, or at least may suffer, some detriment or loss. In a long line of decisions this court has held directors who control corporate action responsible for dereliction of duty where they have used the property of the corporation or managed its affairs to promote their own interests, disregarding the interests of the corporation." 43 N.E. 2d at 19.

Since the evidence indicated that Roth was not financially able to satisfy his obligations to Continental arising out of his earlier breach of his fiduciary duty to it, the argument that the defendants were entitled to a charge that as a matter of law Roth's assignment of his equity in the 67,000 shares of Continental stock had collateral value equal to the market value of the stock, must be rejected. The value, if any, to be attributed to his assignment was one for determination by the jury and it was not unreasonable for the Government to argue that the assignment constituted a worthless right that should not have been considered as security in the sense used in the financial statement.

Most of the other grounds urged by the defendants must be rejected for the reasons stated from the bench on September 6. The contention that there were improprieties in the prosecutor's summation does not warrant any further comment, in view of the defendants' failure to object, even

though there was ample time in which to do so, the Court deferring its instructions and submission of the case to the jury until the day following the prosecutor's summation. *United States* v. *Indiviglio,* 352 F. 2d 276 (2d Cir. 1965), *cert. denied,* 383 U.S. 907 (1966). In view of the express provisions of Title 18 U.S.C. §3057(a) and the collateral nature of the issue, the Court was not required to instruct the jury that no provision of the National Bankruptcy Act obligated the witness Marcheso to cooperate with the United States Attorney for the Southern District of New York.

This was a close, hard-fought case in which there was conflicting evidence with respect to most of the major issues. The proof was thoroughly presented and argued by counsel for both sides. There was sufficient evidence to warrant the jury's finding of guilt. The jury's decision, however, cannot be attributed to any oversight or inadequacy of performance on the part of counsel for the defendants who made an extremely able presentation of their defense.

For the foregoing reasons the motion is denied.

The defendants are directed to appear for sentencing in Room 706 at 10:30 A.M. on September 25, 1968.

So ORDERED.

WALTER R. MANSFIELD
U.S.D.J.

Dated: September 17, 1968.

APPENDIX C

Transcript of District Court Sentencing

APPENDIX C

Transcript of District Court Sentencing

The Court: Well, having sat through this fairly long trial and familiarized myself by way of review again with the detailed evidence that unfolded in the courtroom, and having before me here some very detailed and thorough probation reports with respect to each defendant, which are supplemented by numerous letters from friends to the Court, I think I am in a position to appraise the matter for sentence purposes.

Let me say at the outset that I see no purpose whatsoever to be served by imposing jail sentences in this matter. These three defendants pose no risk to society. Their lives, as reflected in the probation reports, and as they unfolded from my own appraisal of them personally during the trial, and as testified to by the numerous letters of friends that the Court has received, have been exemplary. They are devoted parents; they are respected by their friends and their neighbors; they have worked hard in their lives to support themselves and their families; they are active adherents to their religious tenets respectively.

They have no criminal records whatsoever.

Their professional reputations, and, undoubtedly, their earning capacities are going to suffer very heavily as a result of these convictions, and I suppose they face the possible suspension or loss of their certificates.

Nor do I see that jail sentences would serve any public interest either by way of setting an example or as a deterrent to others.

There has been some talk here by the prosecutor about lying on the witness stand either here or in earlier proceedings. As far as I am concerned, these defendants were

not charged with perjury and I am not going to conclude that they were lying on the witness stand for purposes of deciding what sentence should be imposed.

The fraud charged here involved a highly technical and complex area, about which there is room for considerable difference of opinion, as to what balance sheet disclosure would have been appropriate.

The decision to prosecute this fraud criminally lay entirely within the province of the United States Attorney, and for the reasons I have stated in my decision denying the motions, the post-verdict motions, I must accept the jury's verdict.

But the imposition of sentence is the Court's province and in such a technical area where there was so much difference testified to between experts, I don't believe that the remedy lies in jail sentences.

If anywhere it lies elsewhere. If the SEC believes that disclosures of the type indicated by its officials here should have been made, it has the power to issue regulations. In the light of the jury's verdict, the American Institute of Certified Public Accountants would probably do well to revise the auditing standards and accounting principles sponsored by them. That would be the way rather than by jail sentences to protect the public from this type of risk.

What I have to say is not intended to excuse the conduct of the defendants. Footnote 2, which was the center of the case, struck me as a pretty sloppy bit of business. Poor judgment was shown in checking the collateral and accepting the type of collateral posted, which consisted mostly of the stock of Continental itself, and that was in such a poor financial condition that when the report shortly

was to become public, the collateral was almost sure to take a nosedive in market value.

On this aspect of the case it is difficult not to conclude that the defendants were aware more or less of the footnote's misleading character, regardless of auditing standards and accounting principles.

However, they stood to gain nothing personally by their conduct.

Taking into consideration all of these circumstances, the sentence of the Court will be as follows.

I believe the remaining counts as to which they were found guilty were counts 1, 3 and 6?

Mr. Fleming: Yes, that is correct, your Honor.

The Court: The sentence imposed upon the defendant Carl Simon is as follows:

On count 1, a fine of $5,000.

On count 3, a fine of $1,000.

And on count 6, a fine of $1,000—making a total of $7,000.

The defendant Robert Kaiser is sentenced as follows:

On count 1, a fine of $3,000.

On count 3, $1,000.

On count 6, $1,000—making a total of $5,000.

The defendant Melvin Fishman is sentenced on count 1 to a fine of $3,000.

On count 3, to a fine of $1,000.

And on count 6, to a fine of $1,000.

The fines are to be paid by a week from today by four o'clock.

That is the entire sentence of the Court.

The defendants have ten days, as I am sure counsel is aware, within which to file their notice of appeal.

Thank you, gentlemen.

Are there any inquiries with respect to time on this? If there are, let me know.

Mr. Peck: Your Honor, I assume that we may have a stay of the fines pending appeal?

The Court: Well, normally we do not.

Does the government have any objection to that?

Mr. Fleming: We have no objection to it, your Honor.

The Court: All right, it will be granted.

Mr. Peck: Thank you, your Honor.

APPENDIX D

Statutes and Rules

APPENDIX D

Statutes and Rules

TITLE 18 U.S.C.

"§ 2. PRINCIPALS.

(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces, or procures its commission, is a principal.

"§ 371. CONSPIRACY TO COMMIT OFFENSE OR TO DEFRAUD UNITED STATES.

"If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

"If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment shall not exceed the maximum punishment provided for such misdemeanor."

"§ 1001. STATEMENTS OR ENTRIES GENERALLY

"Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both."

"§ 1341. FRAUDS AND SWINDLES

"Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Post Office Department, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both. As amended May 24, 1949, c. 139, § 34, 63 Stat. 94.

SECURITIES EXCHANGE ACT OF 1934

"Penalties

"Sec. 32. 15 U.S.C. § 78 ff. (a) Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule

or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

"(b) Any issuer which fails to file information, documents, or reports required to be filed under subsection (d) of Section 15 of this title or any rule or regulation thereunder shall forfeit to the United States the sum of $100 for each and every day such failure to file shall continue. Such forfeiture, which shall be in lieu of any criminal penalty for such failure to file which might be deemed to arise under subsection (a) of this section, shall be payable into the Treasury of the United States and shall be recoverable in a civil suit in the name of the United States.

"(c) The provisions of this section shall not apply in the case of any violation of any rule or regulation prescribed pursuant to paragraph (3) of subsection (c) of section 15 of this title, except a violation which consists of making, or causing to be made, any statement in any report or document required to be filed under any such rule or regulation, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact."

FEDERAL RULES OF CRIMINAL PROCEDURE

Rule 23: Trial by Jury or by the Court

(a) *Trial by Jury.* Cases required to be tried by jury shall be so tried unless the defendant waives a jury trial in writing with the approval of the court and the consent of the government.

* * * * *

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No. 1159

IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

CARL J. SIMON, ROBERT H. KAISER, and MELVIN S. FISHMAN, *Petitioners,*

v.

UNITED STATES OF AMERICA, *Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, AMICUS CURIAE, IN SUPPORT OF PETITION FOR CERTIORARI

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February 27, 1970

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This brief *amicus curiae* in support of the petition for certiorari is submitted by the American Institute of Certified Public Accountants (hereafter "Institute") with the consent of all parties. The Institute is the national professional organization of certified public accountants, which has for more than a half century exercised the principal responsibility for the development, promulgation and enforcement of the professional standards that govern the practice of accountancy.